The Thresh thriller

SANTHIE GOUNDAR reviews the curious case of *Desmond John Thresh* and explains why a property transfer with his company was not a profit of his employment.

Cast your mind back to a more innocent time, when the doom and gloom stories of the current recession were nowhere in sight, and house prices were shooting up faster than a rocket being launched into space. With press outpourings regularly reminding us of the subdued property market, it is easy to forget that not too long ago – some time around the early to middle part of the last decade – purchasing a house and selling it a few years later for a mouth-wateringly large profit was virtually taken for granted. This was the backdrop to the transactions in the case of *Desmond John Thresh v CRC* (TC343), which led HMRC to investigate Mr Thresh's 2004/05 self assessment tax return.

Mr Thresh, the sole director and shareholder of Hunt's Construction Limited, was appealing against an amendment made by HMRC to his self-assessment for that year. A builder by trade, Mr Thresh had agreed with an acquaintance, Mr Baxendale, that three cottages were to be built on his land. Mr Thresh would subsequently occupy one of these cottages as his main residence when the building work was completed and Mr Baxendale had transferred that cottage to him at a lower cost. HMRC contended that this transfer constituted a profit of employment under his own company and should be charged to income tax and National Insurance accordingly.

HMRC asked the First-tier Tribunal to give a decision in principle over their contention. Curiously, the tribunal found in favour of Mr Thresh. The judge ruled that, based on the facts, the transfer was made under an arrangement carried out in his individual capacity rather than as an employee or director of Hunt's Construction Limited.

KEY POINTS

- Property built by director and then sold to his own company.
- Transaction structured so that no tax liability arose.
- Decision in principle found in appellant's favour.
- 'One-off case' unlikely to set a binding precedent.

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The facts

Mr Thresh and Mr Baxendale agreed plans to build three cottages in the (one would assume rather large) garden of Mr Baxendale's property, Burleigh House. Once planning permission for the cottages was granted, Mr Thresh sent him a letter dated 1 October 2003 signed on behalf of Hunt's Construction Limited. The letter outlined 'a rough proposal for our joint venture' and set out the responsibilities of both parties, including each cottage's specifications. The First-tier Tribunal summarised this as follows.

> 'At this stage (1 October 2003), therefore, the proposal was that Mr Baxendale would provide the land, the company [Hunt's Construction Limited] would build the three cottages and, on completion, retain two of them, while the title of one cottage [Plot 1] would be transferred by the Company to Mr Baxendale … The reward for the company's construction services would be the two cottages which it retained, while the reward to Mr Baxendale for his contribution of the land together with his provision of planning and other professional fees, would be to take one cottage for himself.'

Mr Thresh told the tribunal that this letter had been sent on the assumption that it was possible to borrow on the security of the land to cover at least some of the cost of the building work, which the Tribunal accepted.

The company's board minute document, dated 9 January 2004, set out a further agreement between Mr Thresh and Hunt's Construction Limited that Plot 2 would be sold to Mr Thresh 'upon completion', with the sale and purchase price equal to 'half the development costs, including direct costs and a proportion of overheads applicable to the project'.

The contracts

In e-mail correspondence dated between 20 April and 22 April 2004, Mr Thresh asked his solicitor if he could prepare a 'legally binding agreement' between himself and his company to buy one of the remaining plots for himself 'in exchange for me sourcing this deal for the company'. The solicitor told Mr Thresh that 'the agreement with Mr Baxendale allows for the transfer of either plot into either the company's name or as the company may direct. Accordingly there is no difficulty in the plot being transferred to yourself'.

While no such sale contract between Mr Thresh and his company was drawn up in the end, a formal contract between the company and Mr Baxendale relating to the site development was entered into on 27 September 2004. Work on the site had actually begun in June of that year – before the formal contract with Mr Baxendale had been signed – and the construction work was completed in October 2004 without any trouble.

The contract between the company and Mr Baxendale stated the value of all three cottages as £175,000. Both parties sought professional advice before agreeing this figure. However, the contract also provided that 'Baxendale will transfer title to Plots 2 and 3 to or by the direction of Hunt's upon their producing the NHBC (National House Building Council) or equivalent certificate and the local authority certificate of completion. Baxendale will take possession of Plot 1 on receipt of the same certificate'.

The Tribunal noted as follows:

> 'We find, therefore, that before April 2004, and probably before 9 January 2004, but after 1 October 2003, the basis for the joint venture between Mr Baxendale and the company had changed … After the change, Mr Baxendale was to retain title to all plots while the building works were carried out and would on completion … transfer title to Plots 2 and 3 to or by direction of the company, and … take possession of Plot 1.'

The new scenario

Mr Thresh told the court that the change came about after Mr Baxendale had been advised that it was 'unwise' to transfer the title in the land to Hunt's Construction Limited because he would have no protection in the scenario of the company becoming insolvent. The Tribunal accepted the explanation as probable and went on to expand further:

> 'The important point, however, is that this change in the basis on which the project would be carried out meant that the appellant (as director of the company) had to find an alternative means of financing the company's participation in the project … Clearly, by 9 January 2004, the appellant had decided to invest half of the development costs from his private resources and, in return, take one of the cottages (Plot 2) into his own ownership.'

Extracts of Mr Thresh's director's loan account with his company showed that Mr Thresh paid a total of £105,000 in three separate instalments to Hunt's Construction Limited. Funds were raised by mortgaging another property and were described in the company's accounts as '(mortgage) re Burleigh Cottages'. HMRC agreed that half the actual development costs was £104,284.

The newly built cottage on Plot 2 was transferred from Mr Baxendale to Mr Thresh in a transfer document dated 1 November 2004 for a consideration of £58,333 – a third of the agreed total value of £175,000 for all three cottages. As Mr Thresh had separated from his wife in late 2003, he used the Plot 2 cottage as his residence.

The cottage on Plot 3 was transferred from Mr Baxendale to Hunt's Construction Limited in a separate document of the same date for the same consideration. Mr Thresh subsequently sold the cottage on Plot 2 to Hunt's Construction Limited for £190,000 in 2006. The company still owns both cottages and currently lets them out to tenants.

"HMRC alleged that Mr Thresh had implemented an income tax and National Insurance contributions avoidance scheme."

HMRC's arguments

HMRC alleged that Mr Thresh had implemented an income tax and National Insurance contributions avoidance scheme; that while he had moved into the Plot 2 cottage and made it his personal residence, it had always been his intention to sell it to his company later. In addition, the company acquired the cottage at a much higher base cost, thanks to the huge leaps in property prices between 2004 and 2006, than would have been the case if Mr Thresh had not owned the cottage himself during that time.

The department accepted that as the cottage had been Mr Thresh's only or main private residence during that period, the capital gain from the period was exempt from capital gains tax. As a result, the Tribunal was not asked to consider any capital gains tax implication of the transactions outlined in the case.

HMRC argued, however, that the transfer of the cottage from Mr Baxendale to Mr Thresh on 1 November 2004 at an undervalue constituted a profit of Mr Thresh's

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employment under his company which was 'money's worth'. As a consequence, this would therefore be treated as 'earnings' within the charge to tax on employment income for 2004/2005 as defined by ITEPA 2003, s 6, s 7(3), s 62(2) and s 62(3).

The *Wilkins v Rogerson* case

Mr Thresh's accountant referred the tribunal to *Wilkins v Rogerson* [1960] 39 TC 344, where it was decided that the employee receiving a tailored suit from his employer received a 'money's worth' taxable benefit, and that the taxable amount was the market value (in this case, the second-hand value) of the suit at the point when it was transferred into the employee's ownership.

The accountant argued that Mr Thresh's case differed from *Wilkins v Rogerson* as the cottage had not been transferred from the company to the taxpayer, who had instead risked his own money on the project, and that this was 'evidently a transaction on arm's length terms, because [Mr Thresh] and the company were each taking half the risk and each was receiving half the reward' as set out in the board minute of 9 January 2004.

> ***"HMRC argued that the receipt of the cottage at an 'undervalue' was a 'money's worth' benefit assessable as earnings from employment."***

He summarised that:

> '… Any profit to [Mr Thresh] in the transfer to him of the cottage was not properly taxable as earnings from his office or employment under the company … because it was a reward for his having taken the risk involved in financing one half of the development costs of the project.'

In a seemingly strange twist to the plot, HMRC also used the *Wilkins v Rogerson* case to argue that the receipt of the cottage at an 'undervalue' *was* a 'money's worth' benefit assessable as earnings from employment. The assessable 'benefit' was the profit that would have been realised if the cottage was immediately sold on the open market. This crystallised on 1 November 2004 – the transfer date of the 'money's worth benefit' – in the 2004/05 tax year.

HMRC submitted that:

> '… The benefit was received by reason of the appellant's employment because he had acted … entirely in his capacity of sole director of the company, and not as an individual.'

HMRC also noted the payments totalling £105,000 that had been made via Mr Thresh's director's loan account, but the department argued that the payments 'should be regarded as injections of funds into the company to be used by the company for its purposes, rather than as contributions towards the building costs made by the appellant'.

This argument was rejected by the First-tier Tribunal as the evidence clearly showed that the funds were contributed specifically for the building costs of the cottages.

The decision

Having heard the arguments, the First-tier Tribunal concluded its judgment as follows.

> 'We hold that the transfer to the appellant of the cottage, assuming it was a profit to him or "money's worth", was not received by him by reason of his office or employment under the company, but, instead, by reason of his arrangement with the company (entered into in his individual capacity and not as a director or employee) that he would provide financial assistance to the company to enable it to carry out the development in return for the transfer to him of the cottage on completion … it seems to us that the arrangement on these terms was such as might have been agreed by the company with an arm's length joint venturer. For these reasons we decide in principle (in the appellant's favour) that the transfer to the appellant of the cottage did not constitute a profit of the appellant's office or employment under the company.'

It was decided that both parties should be left to agree on how the appeal will be disposed.

Implications

For the time being at least, it would seem that Desmond Thresh has no further liability to income tax, National Insurance contributions or even capital gains tax from acquiring, living in and selling a property built by his own construction company. However, it must be noted that the facts and circumstances of this case are highly unusual – not least that the land was provided by an acquaintance. As a one-off case with an unexpected result it probably cannot be taken as setting a binding legal precedent.

One thing that does come out of all this is that Mr Thresh was very careful in setting out the commercial arrangements for the deal, planning and documenting each stage very thoroughly. As the decision was found on the facts, the curious case of Desmond Thresh shows what can be achieved when all the circumstances can be clearly laid out and verified. ■

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